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ABSTRACT

Arrangements in educational institutions for voluntary early retirement programs are discussed. Retirement at any age can be a profound and stressful lifetime change; and it can also represent a welcome transition into newly satisfying and rewarding opportunities. The focus is on: mandatory retirement (exceptions and the new meaning of "early"); tenured faculty and early retirement (faculty perspectives); current retirement age patterns; general types of early retirement programs; health insurance coverage; defining eligibility (age discrimination requirements); early retirement financial incentives (the defined contribution pension plan, elective section 403(b) tax-deferred annuities, special elections for tax-deferred annuities, section 457 deferred compensation plans, section 457(f) deferred compensation plans, severance pay and hand-shake agreements, and defined benefit plans). The pros and cons of an early retirement program will require careful consideration by the college and by individual faculty and staff. A personal financial assessment is the first step for an individual in evaluating the adequacy of an early retirement incentive plan designed to provide additional retirement income. Employers must encourage financial planning at an early stage. Contains 18 references. (SM)

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Voluntary Incentive Early Retirement Programs

This issue of ***Research Dialogues*** *discusses arrangements in educational institutions for voluntary early retirement programs. Retirement at any age — early, normal, or late — can be a profound and stressful lifetime change. It can also represent a welcome transition into newly satisfying and rewarding opportunities. Partly because of the financial implications, programs designed to facilitate early retirement add extra planning challenges. Various aspects of early retirement planning are reviewed here for the consideration of administrators, faculty, and staff.*

The first question about early retirement is "what is early?" Conventionally, early retirement has usually meant retirement prior to age 65, the "normal" retirement age. As a normal age, 65 has certain historical and institutional roots. In the half-century-old social security program 65 is the first age at which unreduced old-age benefits can be started. In employer-sponsored pension plans, 65 has been a traditional normal age. In defined benefit pension plans, 65 is the age at which the full formula benefit normally applies. In defined contribution plans, 65 is the age at which the stated contribution rate and assumed investment returns aim to provide an appropriate level of annuity benefits. Finally, until the passage of the 1978 Amendments to the Age Discrimination in Employment Act, 65 was an age at which employers could mandate retirement.

Mandatory Retirement. The 1978 amendments to the Age Discrimination in Employment Act raised from 65 to 70 the earliest age at which an employer could require retirement for age, effective January 1, 1979. Eight years later (1986) further amendments eliminated ("uncapped") mandatory retirement altogether for most employees, effective January 1, 1987. Both amendments contained temporary exceptions for tenured employees.

Exceptions. The 1978 amendments allowed tenured employees to be retired at 65 instead of 70 through June 30, 1982, a 4½-year grace period. The 1986 amendments provided for an exception to "uncapping" for tenured employees through December 31, 1993, a 7-year period. Utilization of the exception was optional for employers. The 1986 law also provided for a study by the National Science Foundation of retirement of tenured employees to help determine if the exception should be continued beyond 1993, although the study still awaits federal funding.

The New Meaning of Early. In just an eight-year period, from 1978 to 1986, the age at which employers can mandate retirement for age moved from 65 to 70 to "uncapped," with only tenured employees exempted from "uncapping" through 1993. (The ADEA amendments do not apply to employers of 20 or fewer workers or to highly compensated executives in policy making positions[11]) Although normal retirement ages generally remain at 65, the normal and mandatory ages no longer coincide. This divergence suggests that a new definition has been imposed on the idea of when retirement is early.

When early retirement incentive plans are offered, each employing institution will choose its own definition of

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early retirement. When the stated normal retirement age and the permitted mandatory age were identical at age 65, retirement was early when it took place at any age under 65. When the mandated age moved to 70, early retirement could mean retirement before the normal age, but it could also mean retirement later than the normal age but prior to the mandatory age. Thus, Jay L. Chronister and Thomas R. Kepple, Jr., in their recent monograph on early retirement in academic institutions, describe early retirements as those taking place before an institution's designated regular *or* mandatory age[2]

A similar definition was presented in a recent study of early retirement programs by the Consortium on Financing Higher Education (COFHE), an institutionally supported organization composed of 30 private colleges and universities with a national undergraduate student-body pool. It defined such programs as "designed to facilitate and encourage the retirement of faculty and certain categories of professional staff at an age earlier than the mandatory age 70."[3]

For "uncapped" employees, and for tenured employees after 1993 unless the age-70 exception is renewed by Congress, "early retirement" may possibly be defined — depending on an institution's objective for its retirement incentive arrangements — in a way that includes retirements taking place at an age even later than 70. On the other hand, where an institution does not plan to offer an early retirement incentive program, and may simply want to define eligibility for retiree health insurance coverage, a somewhat different definition of early retirement may be considered appropriate. Thus, early retirements could be those taking place prior to the normal age, and late retirements could be those taking place at any age later than the normal age, including at the mandatory age if there is one.

Tenured Faculty and Early Retirement

With mandatory retirement of tenured college faculty no longer possible prior to age 70, some college administrators have expressed concern that future rates of voluntary faculty retirement at ages below 70 will diminish. If the result is an aged, top-heavy faculty, younger faculty would have fewer opportunities for tenured positions. There is also concern about future faculty shortages. A lack of available tenured positions for younger faculty might discourage young people from choosing to teach at the college level or might reduce their confidence in obtaining tenured status once a career has started.

The recently completed report of the Carnegie-sponsored Commission on College Retirement voiced such a concern about future faculty shortages. It recommended retirement by contract. The report observed: "It is the essence of the tenure system that, after an extended period of job security, there be faculty rotation through retirement without a performance review and at an agreed-upon age."[4]

Similarly, the Consortium on Financing Higher Education noted an interest in early retirement plans as a means of "freeing positions for young faculty in periods of non-expansion."[5] Chronister and Kepple (1987) also found substantial interest among colleges and faculty members in early retirement arrangements for tenured faculty."[6]

Numerous concerns about eliminating mandatory retirement for tenured faculty were expressed at the time Congress was considering the 1986 amendments to the Age Discrimination in Employment Act, amendments which ultimately did eliminate mandatory retirement altogether, but as noted earlier, contained a temporary exemption for tenured employees.

The Commission on College Retirement stated its belief in a fixed retirement date as a "central pillar of the tenure system [promoting] job security, academic freedom, [and] the development of a reasonable pension system."[7] The American Council on Education also expressed its support for a mandatory retirement age noting that "the end of mandatory retirement would allow tenured professors to remain in service indefinitely, thus radically altering institutional personnel policies."[8] The American Association of University Professors argued for a mandatory age, asserting that "the fact that the institution of tenure is widely perceived as exacerbating the harm that uncapping is expected to cause may make tenure a more likely target."[9]

Of apparent concern to some educational institutions is the possibility that a substantial number of tenured faculty will reach age 70 in 1994 and immediately thereafter, just as the temporary exception that permits mandated retirement at 70 expires. The Consortium for Financing Higher Education expressed this concern in its 1987 report noting that projections for public and private universities surveyed showed "a *substantially* higher number of faculty over age 55 in 1994 than there are in 1987."[10]

If some colleges are concerned about too few retirements among older tenured faculty, others are concerned about too many, or about too few in some disciplines and too many in others. A study prepared by the Office of Planning and Analysis of Pennsylvania State University found that there may be considerable difficulty in replacing faculty in some disciplines with an adequate number of Ph.D.-trained graduates, especially in traditional fields such as the languages, humanities, engineering and life sciences. In these instances, early retirements among senior tenured faculty could handicap an institution in its course offerings and research activities![11]

Just how any particular college or university would be affected by the retirement age choices of tenured faculty depends on the specific faculty age profile at each institution. An institution's analysis of its own faculty age distribution and of the ages of retirement currently being chosen by the faculty will necessarily precede a determination of how particular patterns of early, normal, or late retirements would affect the institution, or would affect different academic departments. Interestingly enough, the recent COFHE study revealed that a number of surveyed institutions did not keep records that would enable them to supply this basic type of information. Most of the public institutions and several of the private ones, for example, could not provide a headcount of current faculty retirees![12]

Faculty Perspectives. A successful early retirement incentive program will rely heavily on (1) how faculty weigh the pros and cons of early retirement, (2) how the program is presented, and (3) whether the program truly meets faculty needs.

For individual faculty, the retirement

decision is clearly an important one. Chronister and Kepple (1987) identified items regarded by faculty as of primary importance in a decision to retire. These were adequacy of retirement income, impact of future inflation, adequacy of health insurance coverage in retirement, personal health, and continuation of access to valued institutional services (such as office space, mail address, library facilities, secretarial help, faculty club membership, and continued participation in academic and campus events). Other concerns were also identified as important, including loss of salary at a time when earnings may be at a peak level and loss of regular contact with students and faculty colleagues.

A survey of faculty over age 45 in the state of Oregon's higher education system found that the three most important conditions for a positive attitude toward early retirement were adequacy of income, continuation of health insurance, and an option for part-time professional service at the institution![13]

Current Retirement Age Patterns

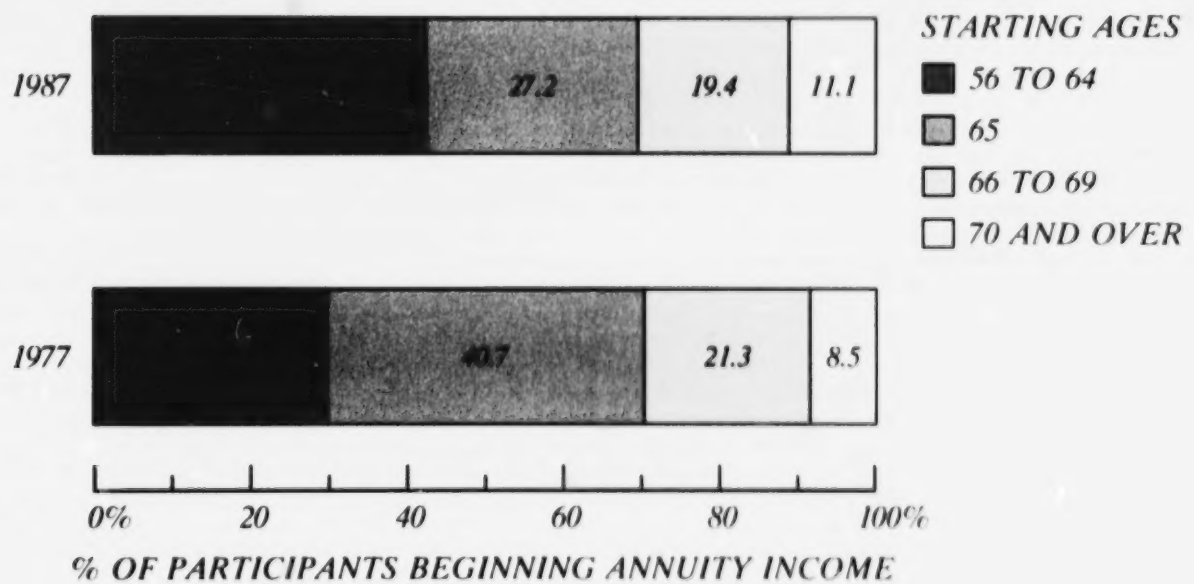
The retirement ages actually selected by employees at the higher ages may differ substantially among employers. Each employer, consequently, will be responsible for monitoring the patterns and trends of its own groups — faculty and staff in the case of educational institutions. The patterns observed may or may not accord with larger trends in the economy as a whole. And, along with other institutional considerations, local patterns may or may not suggest that the institution give consideration to an early retirement incentive program.

That there is a nationwide trend toward earlier retirements is suggested by a number of studies. The Social Security Administration reports that old-age benefits are being started at increasingly earlier ages. The number of social security beneficiaries starting their benefits at age 62, for example, rose from 41% in 1967 to 58% in 1980. During the same period, the percentage of those who began their benefits after age 62 but earlier than 65 remained virtually the same at 30%. Conversely, for those beginning benefits at 65 and older, the percentage decreased from 38% in 1967 to 19% in 1980![14]

A trend toward early retirements is also suggested by data on the age at which TIAA-CREF participants start annuity income, shown in Chart 1. The proportion of participants who began benefits prior to age 65 increased from 29.6% in 1977 to 42.3% in 1987. Over the same period, the proportion beginning benefits at age 65 decreased from 40.7% to 27.2%. The proportion of participants starting their annuity income at ages 66 and higher remained about the same, 29.8% in 1977 and 30.5% in 1987.

Some studies suggest that the average faculty retirement age continues to center around 65. The 1987 study by Pennsylvania State University of faculty retirements over a 5-year period concluded that the retirement age for the majority of faculty stayed nearly the

CHART 1: TIAA-CREF ANNUITY INCOME STARTING AGES 1977, 1987



same between academic years 1981-82 and 1985-86. Significantly, about two-thirds of retiring faculty had left by the age of 66. The study's authors concluded that "the average age of retirement bears no obvious correlation to mandatory retirement age."[15]

The 1987 study of 36 institutions by the Consortium on Financing Higher Education portrays a slight upward trend in retirement age of faculty in these institutions. In the 36 institutions surveyed, the average retirement age of faculty rose from age 64.6 in the academic year 1982, to 65.2 in 1983 and 1984, to 65.3 in 1985, to age 66 in 1986. The range of average retirement ages for all the surveyed institutions in the 1986 academic year was from age 61 to age 70. The study also reported that for the academic years 1982 through 1986, 72% of the faculty retired at an age earlier than the mandatory retirement age![16]

General Types of Early Retirement Programs

Early retirement incentive programs can offer *full retirement* at "early" ages as defined by the program, or *partial or phased retirement*, or both. Under either type, the arrangement is offered on a voluntary basis. For those who accept the arrangement, it states the age at which the accepting employees will retire from active service. From the employer's standpoint, the arrangements are usually offered as a means of reducing employer costs or of opening up positions for younger employees.

In a partial or phased arrangement, employment continues on a part-time basis until retirement takes place. During the part-time period, employment may, for example, be on a half-time basis, but the portion of salary that is continued may be 60 or 70% of the former full salary. The continuing regular annuity contributions will normally be based on the employee's actual salary during the phased retirement period. Or, an arrangement may specify that annuity contributions for employees electing phased retirement will be based on the prior salary level before phased retirement began.

In a phased retirement program, a portion of the employee's regular retirement annuity may be started when the phased retirement begins, or the start of the annuity may be deferred until actual retirement takes place. The duration of the period of partial or phased retirement will be specified in the arrangement, with full retirement taking place at the specified age.

A "bridging" approach to the provision of early retirement benefits may be used. For example, if an early retirement program provides for full retirement prior to age 62 (the age at which reduced social security benefits first become available), a bridge benefit may be provided. During the stated bridging period, bridge benefits are paid until the time the social security benefits are to begin, at which time the bridge benefits cease or are reduced.

Early retirement offerings cannot be used to force people to retire. They must be voluntary.

A bridging approach may also be used in early retirement programs which provide for a period of delay in the start of regular defined contribution annuity benefits following early retirement or during phased retirement. The delay permits higher monthly annuity benefits to become payable at the time the annuity is started, a function of the shorter average life expectancy at the employee's later age and of the continued growth of the full annuity accumulation from its investment earnings. The bridging benefit provides income support in the meantime.

Generally, the financial incentives that are offered under a program to encourage early retirement may provide for *lifetime* supplements to the regular annuity benefits payable under the plan, and/or *temporary* benefits, such as phased retirement arrangements, bridge benefits, or special benefits such as severance pay, deferred compensation, or special bonuses.

Health Insurance Coverage

Hospital and medical expenditures increase with age. In considering early retirement, employees should be made aware of the financial aspects of health care insurance coverage in retirement.

Recent surveys by TIAA-CREF indicate that most educational institutions provide for the continuation in their employee group health insurance plan of employees retiring both before and after age 65, and of their dependents. Retired employees who reach age 65, and employees who retire at age 65 or later, will become covered by Medicare. But additional health care coverage will be important and is needed both before and after age 65; a satisfactory early retirement program will be expected to take this into account.

Defining Eligibility

An early retirement incentive arrangement should clearly define the groups of older and long-service employees to whom it is offered, whether for full early retirement or for phased retirement. For example, a program may be offered to management and professional employees, or to tenured employees, or to other specifically identified employee categories. The programs typically designate specific groups which may be narrowly defined.

Early retirement offerings cannot be used to force people to retire. They must be voluntary. Benefits provided under qualified pension plans and tax-deferred annuities cannot be targeted to benefit only highly compensated employees. On the other hand, nonqualified deferred compensation plans can be designed to benefit only the highly compensated, and in fact must be targeted to select groups of employees, such as tenured faculty, in order to avoid becoming subject to the provisions of the Employee Retirement Income Security Act.

In addition to defining the eligible groups, the arrangements will generally set forth the conditions which must be met by the employees in the groups. These eligibility requirements for early retirement usually combine a minimum number of years of service with an attained age or with a span of bracketed ages. For early retirement programs for tenured faculty, the 1987 study of early retirement plans by the Consortium on Financing Higher Education found that 10 or 15 years of service were the most frequently stated service requirements. The eligibility age for phased retirement arrangements was usually stated

on a bracketed basis, such as 60-64, 57-62, 60-67, etc. The age requirements for incentives for full retirement were usually stated as beginning with an age such as 55, 57, 60, or 62, or were stated as bracketed ages, such as 62-69, 62-67, 60-67, etc.

Age Discrimination Requirements. Inducements for voluntary retirement are usually offered to senior and long-service employees. The courts have generally concluded that early retirement plans are not discriminatory because an offer of early retirement incentives is a benefit to the recipient and not a sign of discrimination. Moreover, the voluntary nature of the offer implies neutrality of position rather than discrimination.

An early retirement incentive program offered to older, long-service employees may be made available for a limited period of time. Where a program is offered for a limited time — that is, a "window" arrangement — there can be a question of whether pressure to accept during a particularly short time may constitute coercion. The issue is whether a window arrangement is offered in a way that provides eligible employees with sufficient time to consider all aspects of what may be a crucial and complex decision.

To avoid any implication of coercion, it is important that an arrangement be designed to provide a reasonable time for decision making, that it provide adequate information, and that it avoid the incorporation of provisions that convey a sense of pressure. These questions should be considered: (1) Did the person receive adequate and full information that was not misleading? (2) Did the person have an opportunity to say no? (3) Did the person have sufficient time to digest the information necessary to make an informed choice?

Early Retirement Financial Incentives

For employers, a basic question is what financial incentives can be developed in order to induce or encourage early retirement. For employees, the issue is whether voluntary early retirement is affordable and what amount of financial inducement will be needed. For both, there is a question of how objectives will be affected by the relevant provisions of federal tax laws.

Since each institution will have its own retirement goals, age and tenure profile, and resource limitations, early retirement incentive programs will necessarily differ among different institutions. As incentives for early retirement, employers may consider a number of possible avenues of approach:

- the defined contribution pension plan
- elective tax-deferred annuities
- special elections for tax-deferred annuities
- deferred compensation plans
- severance pay and hand-shake agreements
- defined benefit plans

The Defined Contribution Pension Plan. Federal tax laws have increasingly limited the extent to which defined contribution pension plans and deferred compensation plans can provide extra incentives for early retirement. The most recently enacted limits were in the Tax Reform Act of 1986.

Since each institution will have its own retirement goals, age and tenure profile, and resource limitations, early retirement incentive programs will necessarily differ among different institutions.

Generally, the federal limits put a ceiling on the amounts of employer pension and deferred compensation contributions that will not be currently taxable as income to employees. There is an overall limit and certain internal limits.

The overall federal limit to contributions to defined contribution retirement plans is the lesser of $30,000 or 25% of the individual's compensation. Compensation means salary and taxable benefits as stated on the W-2 form, and it does not include any previously deferred compensation or current deferrals, such as salary reduction for tax-deferred annuities. This same limit applies to the Section 403(b) tax-deferred annuity plans of educational organizations, except that there are also further limits to tax-deferred annuity contributions, which are described below. The effect of the overall defined contribution limit is that the sum of the employer contributions, employee contributions whether through salary reduction or deduction, and any forfeitures cannot be more than $30,000 or 25% of the individual's compensation, whichever is less![17]

Elective Section 403(b) Tax-Deferred Annuities. There is an additional separate dollar limit on contributions to the elective deferrals available to employees in public and private educational institutions through Section 403(b) tax-deferred (tax-sheltered) annuities. Such deferrals are usually made when employees elect to make salary-reduction contributions to a Section 403(b) tax-deferred annuity. No more than $9,500 may be electively deferred tax free. It may also be less, since as a further limit it may be no more than the "exclusion allowance" under Section 403(b), which is equal to 20% of salary after any salary reduction for the current year, times the number of years of service completed with the present employer, less all retirement contributions made by the current employer (including salary reduction payments) not included in taxable income in prior years.

In 403(b) plans, employees may make required employee contributions through either salary deduction or salary reduction. These are offset against employer contributions to Section 403(b) defined contribution plans. As a result, each employer may make additional contributions to a Section 403(b) plan on behalf of an employee only to the extent that such contributions, when aggregated with contributions made by the employee under the employer's plan during the tax year, do not exceed the overall limit, i.e., the lesser of $30,000 or 25% of salary. The effect of this is that the more an employee elects to defer through a tax-deferred annuity, the less can be applied by an employer toward extra tax-deferred pension benefits by supplementing the regular retirement plan for the purpose of inducing early retirement.

In any event, elective deferrals of employee salary based on salary reduction agreements will not provide *extra* early retirement income beyond amounts which an employee can normally arrange for on his/her own through salary reduction. Elective deferrals could provide increased future retirement income only if an employee's salary were increased for the purpose of increasing such deferrals. And the prescribed limits, in any case, would still prevail. However, some leeway for deferrals is available in the so-called "special election" provisions available to employees of educational organizations who have 15 years or more of service with their employer.

Special Elections for Tax-Deferred Annuities. The main purpose of the special election provisions of the Internal Revenue Code is to enable relatively long-service employees of educational institutions to elect to have their employer make additional tax-deferred annuity contributions on their behalf through salary reduction in order to make up for relatively smaller plan contributions that might have been made in earlier years. The increased contributions under the special election rules are not taxed to the employee as income in the year in which the contributions are made.

The special election rules provide that the $9,500 limit on contributions to a tax-deferred annuity will be increased by the least of one of three amounts. Thus, contributions to a tax-deferred annuity for any taxable year can be increased by the least of the following: (1) $3,000, (2) $15,000 reduced by amounts not included in gross income for prior taxable years by use of the special rule, or (3) the excess of $5,000 multiplied by the number of years of service of the employee over the employer contributions made to the tax-deferred annuity of the employee for prior taxable years. From this statement it can be seen that the extra amounts of tax deferral in any one year can be no more than $3,000, and perhaps will be less.

The special election can be used for retirement income supplementation in two ways: (1) an employee can reduce current salary on his/her own to increase future retirement income, or (2) the employer can utilize the employee's special election to provide additional early retirement benefits by increasing the employee's salary by the amounts that may be tax deferred under the special election, and then contributing those amounts to the tax-deferred annuity.

Special elections make it possible to increase income deferrals and can be helpful in some situations. But because each eligible employee's potential deferrals under a special election may differ, and because limits still prevail, the potential value of special elections can be determined only by making a calculation for each employee, essentially an ad hoc approach. Further, since extra deferrals under special elections are year-by-year events, a maximum use of special elections for early retirement can be obtained only by starting the increased salary and deferral process several years before early retirement is scheduled.

Section 457 Deferred Compensation Plans. Section 457 of the Internal Revenue Code provides rules under which unfunded deferred compensation plans may be offered. If a plan complies with the rules of Section 457 (i.e., is an eligible deferred compensation plan for Section 457), the deferred compensation and the income attributable to it will be taxed when paid or made available to the employee.

Limits on Section 457 plans that previously applied only to public employers were extended by the Tax Reform Act of 1986 to all employers, including nonprofit educational institutions. As a result, deferred compensation plans are now of limited use for two reasons. First, a $7,500 limit has been applied to annual deferral amounts under deferred compensation plans. (An expanded limit can apply in the employee's last three years before reaching normal retirement age under the employer's pension plan. This limit is the lesser of $15,000 or the sum of unused limits from prior years.) Second, a deferred compensation plan cannot generally be added on top of deferrals under a Section 403(b) tax-deferred annuity.

The law states that deferrals under tax-deferred annuities reduce the deferrals that can be made under deferred compensation plans. Since there is more room for elective deferrals under tax-deferred annuities ($9,500 yearly maximum), which are vested and funded, than under deferred compensation plans ($7,500 yearly maximum), which cannot be funded, deferred compensation plans generally take a back seat when it comes to supplementing future income of employees in educational institutions. However, since the limit for deferred compensation plans is $7,500 or 33⅓% of compensation, and the 403(b) limit is $9,500 or 20% of compensation, there may be some situations in which an excess is available for use under deferred compensation plans compared with 403(b) plans.

Section 457(f) Deferred Compensation Plans. Section 457(f) of the Internal Revenue Code has special rules for plans which are not defined as "eligible" deferred compensation plans in Section 457. Because ineligible deferred compensation plans as defined in Section 457(f) do not meet the requirements of the rest of Section 457, there is a further requirement that in order to avoid immediate inclusion of the deferred amounts in the employee's current taxable income, the stated amounts of deferred compensation must be subject to a "substantial risk of forfeiture." This means that there must be a future service requirement stated as a condition of receiving the benefit. It is important to note that "ineligible" deferrals are not subject to an overall annual maximum limit such as the $7,500 prescribed for "eligible" deferrals.

Under ineligible deferred compensation (Section 457(f)) plans, the employer agrees to pay the employee on retirement a lump-sum amount or a monthly income for a specified period of time. Section 457(f) plans can take the form of a written agreement between the employer and employee, but the amounts deferred must remain the property of the employer. There is no requirement that the form of pay-out be elected by the employee at the time the agreement is signed.

While Section 457(f) deferred compensation is not taxed currently as income to the employee, it does become includible in the employee's gross income during the first taxable year in which there is no substantial risk of forfeiture. A net amount then paid for an annuity income, for example, would be considered the cost of the annuity in calculating the tax on future payments under Section 72 of the Internal Reve-

nue Code. It can be seen that this tax treatment is a major difference between the eligible deferred compensation arrangements under Section 457 and the ineligible deferred compensation arrangements under Section 457(f). It should be noted that there is some controversy about the Internal Revenue Service's position. At present, an argument can be made that as long as the arrangement is unfunded, only the amounts made available each year would be taxable.

The risk of forfeiture is generally lifted when the employee retires at the time specified in the agreement, or dies or becomes disabled. Prior to that time — while the employee continues to work — there is no addition to his/her taxable income due to the signing of the agreement, the reason being that the employee would forfeit the rights to the deferred compensation if employment did not continue until the early retirement date.

If the employee takes the entire lump-sum value into income when the risk of forfeiture is lifted, there is no reason why the arrangement cannot be funded. A lump-sum settlement does not qualify for IRA rollover but it could, as mentioned, be used to purchase an insurance company annuity after being taxed when received as a lump-sum. In this latter case, the retiree would have the security of a funded annuity contract.

Severance Pay and Hand-Shake Agreements. Lump-sum (severance) payments at early retirement may also be considered. For example, an employer may consider a plan under which each year employees reaching a specified early retirement age may be offered a lump-sum payment on early retirement. For tenured faculty, a plan of this type might be offered as a tenure buy-out plan. Severance pay arrangements may also be accompanied by other types of benefit supplementation.

Severance payments are taxable as current income to the employee when received and are normally paid by the institution as a part of current operating expenses. The Internal Revenue Service has said that nonelective deferred compensation plans (including severance pay) will be considered deferred compensation plans under Section 457, but they have also stated that they will not be enforcing this until further guidance is provided. There is also pending

Pre-retirement Counseling

Increasingly, employers are recognizing the value of pre-retirement counseling in facilitating employee adjustment to retirement life. Well-defined and attractively presented pre-retirement programs can help create positive attitudes toward retirement, and can contribute to the success of an early retirement program.

With the uncapping of mandatory retirement, there is no fixed date to stimulate individual preparation for the realities of retirement life. And without clearly focused goals, employees will be ill-prepared to make the many decisions affecting retirement.

Retirement is on the top-ten list of stress inducers. Pre-retirement planning helps reduce the anxieties that normally surround early retirement, including concerns about future professional, personal and economic well-being in an unstructured environment. Retirement counseling can have an immediate effect upon an individual's knowledge, which in turn can influence behavior and improve prospects for post-retirement adjustment.

What ages should be targeted for participation in a pre-retirement program? This will depend on the institutional goals and objectives, including both early and normal retirement ages. Many programs invite participation starting at age 50 or 55. However, it may be desirable to involve younger employees, especially if financial planning information is a strong component, or if employees have expressed concern about the future state of social security, the adequacy of the retirement plan, or future prospects for adequate acute or chronic health care provisions in retirement.

Some topics to consider for pre-retirement planning programs include: finances, life insurance, health care, social security, legal affairs and tax regulations; continuation of professional activity; awareness of potential problems and opportunities facing early retirees; and identification of opportunities for retirement and leisure activities. Both the individual and spouse should be involved in thinking about and planning for their retirement lives.

Financial planning is typically the most emphasized element of retirement counseling, and will normally include the following: choices of annuity options under the pension plan, management of IRA and Section 403(b) tax-deferred annuity distributions, investment of discretionary savings for maximum return in retirement, estimates of social security benefits, tax considerations, estate planning, and paying for and planning for health care coverage.

The Consortium on Financing Higher Education's 1987 survey of 36 institutions reported that two-thirds of participating schools currently offer pre-retirement counseling and information services to their faculty. Estimated program costs to the institution per employee ranged from a low of $10 to a high of $1,500. The services range from minimal to very extensive, with a majority offering both group presentations and individual counseling. One example includes a multi-week program which explores overall retirement planning, lifestyle options after retirement, factors which lead to a satisfactory retirement, pre-retirement planning resources, and available community resources. A less extensive program might involve individual counseling on an informal basis in a benefits or personnel office![18]

legislation defining exemptions from Section 457.

Defined Benefit Plans. Most of the defined benefit pension plans covering employees in higher education are administered by state and local governments — public employee and state teacher retirement systems. Defined benefit plans also make up the major source of pension coverage for employees in business and industry.

Incentives for early retirement under defined benefit (formula) pension plans are not subject to the same limits and restrictions as defined contribution plans. Defined benefit pension plans state benefits as a formula — a percentage factor such as 1½% or 2% of "final average" salary per year of service, with the full formula payable at normal age 65 or later, or an actuarially reduced formula payable for retirement at an earlier age (to reflect the longer life expectancy).

One early retirement arrangement that is often incorporated as a permanent feature of public employee and state teacher retirement systems is a provision for payment of the full (unreduced) formula benefit at an age prior to the stated normal age of 65, such as at age 55, for employees who have had a substantial number of years of service at the earlier age, such as 25 or 30 years of service.

Special early retirement incentives offered under defined benefit plans may take the form of providing for a temporary window of added years credited to the service factor in the plan's benefit formula for employees within stated age and service brackets who elect early retirement. Generally, early retirement arrangements must be provided on a nondiscriminatory basis to classes of employees that are clearly identified by objectively stated criteria.

The cost of early retirement benefits under defined benefit plans becomes an addition to the general liability of the plan as a whole and is funded in accordance with funding requirements for plans of this type.

Conclusion

The pros and cons of an early retirement program will require careful consideration by the college and by individual faculty and staff. For the individual, the major financial considerations will be the amounts and sources of retirement income that will be available without special supplementation, plus the question of what amounts of income supplementation will be needed to make early retirement feasible if it is desired.

In retirement — whether early, normal, or late — the greater part of income will usually be derived from the current employer's pension plan, any prior employer's pension plan in which the employee has become vested, and — if retirement is at age 62 or later — social security. There also may be tax-deferred annuity income from elective (Section 403(b)) salary-reduction plans, plus income from a lifetime of personal savings and investment. Through financial counseling and pre-retirement planning sessions, faculty and staff interested in early retirement should gain an initial assessment of income sources and amounts.

A personal financial assessment is the first step for an individual in evaluating the adequacy of an early retirement incentive plan designed to provide additional retirement income. Since each individual's needs and resources are unique, it is important for employers to encourage financial planning at an early stage.

References

[1] Certain types of employees, such as airline pilots, firefighters, police officers, etc., may be retired at earlier ages. The law applies to both public and private employers.

[2] Jay L. Chronister and Thomas R. Kepple, Jr., "Incentive Early Retirement Programs for Faculty: Innovative Responses to a Changing Environment," *ASHE-ERIC Higher Education Reports*, 1987, p. 11.

[3] "Early Retirement Programs for Faculty: A Survey of Thirty-Six Institutions," *Consortium on Financing Higher Education*, Nov., 1987, p. 27.

[4] Oscar M. Ruebhausen, "Age as a Criterion for the Retirement of Tenured Faculty," *Retirement Ages for College and University Personnel*, Commission on College Retirement, January, 1986, p. 32, 34.

[5] *Consortium on Financing Higher Education*, 1987, p. 1.

[6] Chronister and Kepple, "Incentive Early Retirement Programs for Faculty," 1987, p. 8.

[7] Oscar M. Ruebhausen and Thomas C. Woodruff, "Retirement Programs for College and University Personnel," *Academe*, Bulletin of the American Association of University Professors, July-August, 1986, p. 8.

[8] "A Higher Education Agenda for the 99th Congress," *Educational Record*, American Council on Education, Winter, 1985, pp. 43-44.

[9] "Working Paper on the Status of Tenure Without Mandatory Retirement," *Academe*, Bulletin of the American Association of University Professors, July-August, 1987, p. 45.

[10] *Consortium on Financing Higher Education*, 1987, p. 8.

[11] Gregory G. Lozier and Michael J. Dooris, "Is Higher Education Confronting Faculty Shortages?," *The Pennsylvania State University*, Office of Planning and Analysis. Paper presented to the Association for the Study of Higher Education, November, 1987, p. 7.

[12] *Consortium on Financing Higher Education*, 1987, p. 9.

[13] Barbara A. Mitchell, "Early Retirement in Higher Education," 1981. Paper presented at the annual meeting of the Association for the Study of Higher Education, Washington, D.C.

[14] Martynas A. Yeas, "Recent Trends in Health Near the Age of Retirement: New Findings from the Health Interview Survey," *Social Security Bulletin*, February, 1987, vol. 50, no. 2, p. 10.

[15] Lozier and Dorris, "Is Higher Education Confronting Faculty Shortages?" 1987, p. 4.

[16] *Consortium on Financing Higher Education*, 1987, p. 13.

[17] Usually one overall limit will apply to all defined contribution plans, but the limit will apply separately to qualified defined contribution plans and tax-deferred annuity plans. An exception to the general rule of treating 403(b) plans separately is made when the special election for 403(b) plans is made.

[18] *Consortium on Financing Higher Education*, 1987, p. 16.